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BEFORE THE
POSTAL REGULATORY COMMISSION
WASHINGTON, D.C. 20268-0001

VALASSIS NSA	Docket No. MC2012-14
VALASSIS NSA	Docket No. R2012-8

OPPOSITION OF THE
THE NEWSPAPER ASSOCIATION OF AMERICA
(May 23, 2012)

The Newspaper Association of America ("NAA")[1] hereby submits that the Commission should reject the Postal Service negotiated services agreement ("NSA") with Valassis.[2] The NSA is intended to serve the special interest of one direct mailer -- Valassis -- and in so doing will cause significant financial harm to newspapers across the country. Moreover, it does not comply with statutory and regulatory requirements. Specifically, the NSA, which is tailored so narrowly that it is not realistically available to any other mailer:

- Would cause undue harm to the marketplace in violation of 39 U.S.C. §3622(c)(10)(B), as the unprecedented rebates and other uniquely favorable terms given to Valassis would enable and subsidize a direct attack by it on newspaper advertising across the nation, causing real and substantial damage;

[1] NAA represents the interests of nearly 2,000 newspapers in the United States and Canada. Its members account for nearly 90 percent of the daily newspaper circulation in the United States and a wide range of non-daily U.S. newspapers.

[2] 77 *Fed Reg*. 27,491 (May 10, 2012) (Order No. 1330), *noticing* Notice of the United States Postal Service of Filing of Contract and Supporting Data and Request To Add Valassis Direct Mail, Inc. Negotiated Service Agreement To The Market-Dominant Product List, Docket No. MC2012-14 & Docket No. R2012-8 (filed April 30, 2012) ("*USPS Notice*").

- Would result in a net financial loss to the Postal Service in violation of 39 U.S.C. §3622(c)(10)(A) by driving as much as $200 million *annually* of newspaper Total Market Coverage ("TMC") mailings out of the mail;

- Would violate 39 U.S.C. §403(c) by conferring one mailer with an unreasonable rate discrimination in the form of extraordinary discounts and a flat rate structure not available to any other mailer; and

- Has a strong likelihood of causing irreparable harm within 90 days, which could not be rectified in a meaningful or timely way by an after-the-fact review by this Commission under Section 3652 or Section 3662.

The Postal Service's need for revenue, volume, and most importantly contribution during its current financial difficulties is understandable. But this attempt to improve its position by partnering with a single large advertising mailer places at risk at least $1 billion of newspaper durable and semi-durable goods insert advertising. In addition to substantial and long-lasting market disruption, the NSA will damage the Postal Service's own interests by causing a net shift of volume to private delivery. And if this NSA is approved, it opens the door to other NSAs that would target other newspaper advertising, so the potential long-run market harm is much larger.

The Postal Service should not be tipping the scales in favor of one company at the expense of that company's many competitors. The newspapers that are the target of the NSA collectively, according to data collected by NAA, pay $500 million in Standard High Density and Saturation postage annually. NAA members inform it that as much as $200 million *annually* of this postage will likely leave the mail if the NSA takes effect, or *almost six times* as much as the Postal Service expects to gain in new revenue from Valassis. The Postal Service can ill-afford yet further financial losses at this time.

The issue is not whether Valassis will win a particular advertiser or not from a newspaper – that is competition. The issue here is the government favoring one mailer over that mailer's rivals in ways that would affect downstream markets. This is particularly egregious because the NSA is based on insufficient information and an poor understanding of the downstream market. If Valassis is allowed to take advertising revenues out of the marketplace through aggressive price reductions, those dollars will have to come from somewhere else. If newspapers respond by moving midweek TMCs out of the mail, the result is less mail and postage revenue than there is today, and the Postal Service and newspapers are both worse off.

The Commission must stop this NSA now. The NSA would inflict market disruption from the start. The harms caused to newspapers and the Postal Service from lost advertising and reduced TMC mail this summer would be irreparable and could not be rectified in an after-the-fact review process conducted a year or two in the future. The Postal Service's failure to make the basic showing required by the statute and the Commission's rules fully justifies rejecting the NSA at this stage.

INTRODUCTION

Newspapers, Advertising For National Retailers Of Durable And Semi-Durable Goods, And The Mail

As this Commission well knows, newspapers depend upon advertising to generate the revenues needed to support the editorial product. Advertising pays for the journalism that newspapers bring to their markets, ranging from news and investigative features to sports and the local arts.

Retail advertising for durable goods and semi-durable goods is an important portion of newspaper advertising and provides significant financial support for the editorial content in newspapers. Based on industry data, NAA estimates that durable and semi-durable goods advertising comprises some 70 percent of newspaper weekend ad revenue.

As the Commission also knows, newspapers distribute advertising through a combination of means. Subscribers receive such advertising in the newspaper, often in the form of preprint inserts. Households that do not subscribe to the print newspaper receive many of the same ads as part of newspaper Total Market Coverage programs. Many TMC programs have long used the Standard mail for nonsubscriber distribution. Some use private delivery for some or all of their TMC products. Mailed TMC products pay either High Density or Saturation flats rates or a combination of both, depending upon the density of newspaper subscribers on particular routes.[3]

Before the recent recession, NAA estimated that newspaper TMC programs reached a peak of about $800 million in Standard Mail postage by 2008. Despite declines during the late 2000's, newspaper TMC mail volumes and revenues to the Postal Service remain substantial. According to a recent survey of the NAA membership, newspapers spend approximately $500 million each year on postage for TMC delivery.

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[3] Although NAA does not have comprehensive figures, it believes that the ratio of High Density to Saturation-rated TMC mail typically ranges from 40-60 to 60-40.

The $500 million in Standard Mail postage paid annually by newspaper TMC programs comprises more than one-quarter of the Postal Service's revenue for the High Density/Saturation flats product. Postal Regulatory Commission, *Annual Compliance Determination FY 2011*, Table VII-11 (March 28, 2012) (High Density and Saturation flats revenue of $1,885,335,000).

Newspapers, of course, face substantial competition from saturation mailers such as Valassis and others in this market. Those entities compete with newspapers to secure advertising from retailers (and others). When a saturation mailer has access to steeply discounted postage rates not available to others, that gives the saturation mailer a pricing advantage over newspapers when dealing with advertisers.

The NSA Enables Valassis To Directly Targets Newspaper Durable And Semi-durable Goods Advertising

It is undisputed that Valassis is the only entity that meets the NSA's eligibility criteria. *Response of the United States Postal Service To Chairman's Information Request No.* 2, Q1(a). Indeed, by limiting the NSA's availability to a Standard Mail saturation flat mailer that has had "shared mail volumes of at least 400 million pieces annually mailed to 50 percent of existing SCF areas," the NSA's criteria governing mailer eligibility describes Valassis in all but name.

Nor, unfortunately, does there appear to be any dispute that the NSA targets newspaper advertising. The Postal Service describes the private sector enterprises engaged in the delivery of the product as follows:

> Numerous alternate delivery or private carrier delivery companies exist that provide household delivery of non-addressed advertising pieces. *In addition,*

> *newspapers use their own or contracted carrier forces to distribute advertising along with the paper to subscribers in local markets, and an increasing number of newspapers use private delivery in local markets for distribution to nonsubscribers*.

Attachment E, at 4 (emphasis supplied); *see also Response of the United States Postal Service To Chairman's Information Request No. 2*, Question 7 (stating that the NSA program would be an alternative to "private carriers or newspaper delivery"); *Response of the United States Postal Service To Chairman's Information Request No. 3*, Question 5(a).

The NSA is intended for "advertising of durable and semi-durable goods retail providers with a physical retail outlet presence in 30 or more states" (*USPS Notice* at 4). Valassis forecasts from a low of 137,900,000 to a high of 440,000,000 mail pieces under the program, each containing 3 to 10 advertising inserts as required by the NSA. Data provided to NAA by its members indicate that up to $1 billion in durable and semi-durable goods advertising would be at risk due to the NSA. The Postal Service tilts the scale more in Valassis's favor through its relaxed definition of durable and semi-durable goods retailers that allows any entity's ads to qualify so long as more than 50 percent of its sales are "durable goods," itself not a well-defined category.[4]

The Postal Service has offered no reason to believe that one to four billion new advertising inserts will suddenly be created. It is far more likely that the NSA targets preprint inserts distributed by newspapers today. Indeed, Valassis's CEO said in a recent investors call that his company's growth has come from

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[4] Attachment B at 3; Attachment C at 1; *see Response of the United States Postal Service To Chairman's Information Request No. 2*, Question 2(a).

newspaper inserts. Nor is there any reason to expect this to be last such effort, as this NSA is the camel's nose under the tent as part of a Postal Service strategy to divert all insert advertising from newspapers.

The Postal Service Appears To Have The Goal Of Driving Newspaper TMC Products Out Of The Mail

A disturbing theme throughout the Postal Service's submissions in this docket is a view that newspapers are a competitor of the Postal Service through private delivery programs. Newspapers do not view the situation in that way. Newspapers compete with Valassis and other direct mailers. Newspaper TMC programs generally would prefer to use the mail for their nonsubscriber distribution, but some have felt compelled to leave.[5] Economic factors account for some of these departures, but the Postal Service bears substantial responsibility for these declines as well.

In particular, repeated Postal Service initiatives that favored saturation mailers with rate advantages and incentives to take business from newspapers drove some TMC programs out of the mail.[6] It should not come as a surprise to the Postal Service that when a customer is treated as less desirable than another, is given higher rates and inferior service, and its business is regarded as a target, the customer might leave. The Mather analysis cited by the Postal

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[5] Valassis is no different from newspapers in its ability to take durable goods advertising to private delivery, which begs the question of why the Postal Service consistently offers it favorable rates while taking actions that push TMC programs out of the mail.

[6] The Postal Service also has proposed operational changes, such as processing High Density flats on Flats Sequencing System equipment and reduced DDU entry, that would reduce service quality.

Service[7] concluded that the higher postal rates charged newspaper TMC programs caused the Postal Service to lose more than 650 million pieces of TMC mail in 2008 and 2009 combined.

If the Postal Service wants to attract TMC mail volume, it needs to offer newspapers fair, reasonable, and nondiscriminatory rates, not target their business revenue by partnering with their biggest rival.

The Rebate Structure Provides Steep Discounts To Finance Valassis's Raid On Newspaper Advertising

The rebate structure facilitates Valassis's long-held desire to target newspaper advertising by offering steep rebates for new pieces, starting at 4 ounces. Under the NSA, Valassis would receive postage rebates of 20 percent for pieces weighing 4 to 6.5 ounces and those weighing over 11 ounces. *USPS Notice*, Attachment C at 2. More importantly, the rebates are even bigger – and take the form of flat rates (not percentage discounts) -- between 6.5 and 11 ounces, the weights at which Valassis expects the vast majority of the new volume.

The Table below compares, at weight levels subject to the agreement, the rebated rates that Valassis would enjoy to the High Density and full Saturation rates paid by TMC mail.[8] Although these numbers are subject to change in years 2 and 3, the NSA is designed to produce similar results:

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[7] *Response of the United States Postal Service To Chairman's Information Request No.* 3, Question 5(c)(i).

[8] To the extent that contributions per piece increase with weight, the effect on this analysis is neutral, because the higher contributions would come from both NSA and non-NSA pieces.

Weight of piece	Valassis NSA Rate[9]	Non-NSA High Density Rate	Non-NSA Saturation Rate
4 oz.	$0.128	$0.187	$0.160
7 oz.	$0.172	$0.254	$0.227
8.9 oz.	$0.172	$0.296	$0.269
10 oz.	$0.211	$0.321	$0.294

For pieces weighing 6.5 to 9 ounces – the heart of the NSA, as Valassis projects the greatest volume in that range -- Valassis's net postage rate would be a flat rate of $0.172. The rebated rate from 9 to 11 ounces would be a flat rate of $0.211. Those flat rates equate to rebates ranging from 21 to 36 percent off of tariff rates.[10] *All* other Standard mailers pay rates that increase with weight between 6.5 and 11 ounces. The rebates also produce perverse rate relationships, such as a 4.9 ounce Saturation flat would pay less after the rebate than a 3.3 ounce flat.

These rebates, payable at year end, not only grant rates unavailable to other mailers, but are steep discounts compared both to Saturation rates and to the High Density rates that many newspaper TMC programs pay. An 8.9 ounce NSA DDU piece would pay 72 percent less than a High Density piece of the same weight. Rate advantages of that magnitude confer Valassis with

[9] *USPS Notice*, Attachment F, Tab Discount Rebate, Column K.

[10] These rebates would adjust in the event of general rate increases to unspecified levels, although remaining in the 22 to 34 percent range. *USPS Notice*, Attachment C at 2.

substantial pricing flexibility (at the expense of newspapers) compared to competing TMCs in the mail that would have to pay full rates.

The NSA Has Few Commitments From Valassis, Which Heightens The Probability Of Market Disruption

Although the NSA contains a number of provisions that the Postal Service labels "mailing and volume commitments," Valassis in fact has made very few actual commitments. The NSA gives Valassis the right to walk away from the deal for free within the first 90 days after it would take effect, and also gives it a right to cancel the arrangement on 30 days notice. If Valassis decided to keep the NSA alive after 90 days, at worst it would have to pay a "penalty" of $100,000, an easily manageable cost for a company of its size[11] for the opportunity to negotiate potentially significant new business. All other conditions in the NSA take effect only if Valassis elects to proceed with the NSA.

This would create a very disruptive dynamic in which Valassis can offer to undercut market advertising rates and cause tremendous harm to newspapers' revenue streams by forcing newspapers to reduce rates in response, only to walk away if it does not secure sufficient commitments from advertisers to mailing any new pieces. The flat rates between 6.5 and 11 ounces will enable it to try to attract incremental advertising inserts into the package at a very low rate, even zero, because the added weight would not increase the postage price. The steeply discounted NSA rate structure offers Valassis a potentially lucrative upside, coupled with very limited obligations.

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[11] Valassis recently reported net earnings of $26.421 million for the first three months of 2012. Valassis Communications Inc 10-Q at 2 (filed May 8, 2012), an increase of $5 million of the same period in 2011.

Consequently, NAA believes that the Postal Service has grossly underestimated the disruptive nature of this NSA, and its potential for irreparable financial harm on itself, on newspapers that mail TMC programs, and on the advertising market generally.

ARGUMENT:

THE NSA ON ITS FACE
DOES NOT COMPLY WITH THE STATUTE

The Postal Accountability and Enhancements Act authorizes "special classifications" such as NSAs, "in accordance with the policies of this title" and only "when available on public and reasonable terms to similarly situated mailers," and that:

> (A) either—
>
> > (i) improve the net financial position of the Postal Service through reducing Postal Service costs or increasing the overall contribution to the institutional costs of the Postal Service; or
> >
> > (ii) enhance the performance of mail preparation, processing, transportation, or other functions; and
>
> (B) do not cause unreasonable harm to the marketplace."

39 U.S.C. §3622(c)(10)(A). The Postal Service here is relying entirely on subpart (A)(i); it does not contend that the NSA can be justified under subpart (A)(ii). Furthermore, its analysis submitted to address subpart (B) is so superficial as to require rejection by the Commission. Because one must understand the marketplace in order to understand the NSA and to its financial consequences, NAA addresses the "unreasonable marketplace harm" factor first.

I. THE NSA WOULD CAUSE UNREASONABLE HARM TO THE MARKETPLACE IN VIOLATION OF SECTION 3622(c)(10)(B)

Section 3622(c)(10)(B) of the PAEA provides that NSAs must not "cause unreasonable harm to the marketplace." Rule 3010.42(f) of the Commission's rules implements this statutory requirement by directing the Postal Service to provide "[d]etails regarding any and all actions (performed or to be performed) to assure that the agreement will not result in unreasonable harm to the marketplace." 39 C.F.R. §3010.42(f).

That requirement is rooted in testimony by Professor John Panzar in Docket No. MC2002-2. Professor Panzar's testimony explained the role of postage rates as an input to a downstream competitive market, and how favoring one mailer can lead to counterproductive adverse net results. The Commission concluded:

> Panzar's testimony illustrates generally why competitive responses must be an important part of the evidence that the Commission considers when it evaluates an NSA. [citation omitted] When there are "downstream" competitors to a "favored" customer such as Capital One, the losses in surplus suffered by these downstream competitors may negate the benefits of the NSA even if it can be shown that postal net revenue and the favored customer's surplus will each increase.

Experimental Rate and Service Changes to Implement Negotiated Service Agreement with Capital One, Docket No. MC2002-2 at 79 (May 15, 2003) (Opinion and Recommended Decision). The Commission subsequently adopted this principle in its rules, noting that it was particularly important for NSAs regarding mail subject to the Postal Service monopoly, as is this one.[12] After enactment of the PAEA, the Commission reaffirmed this requirement in its procedural rules implementing the new law.

In this case, the Postal Service asserts, in an analysis that can only be considered superficial and wrong, that the financial impact of the NSA on the marketplace will be "minimal." It will be no such thing – industry statistics indicate that newspapers could lose about $1 billion of advertising revenues as a consequence of this deal. The Postal Service inaccurately describes the new saturation shared mail program as "an alternative and supplement to existing distribution" (*USPS Notice*, Attachment E, at 6), when it really is an effort to replace an existing distribution channel – namely, the Sunday/weekend newspaper preprint package. The Postal Service further argues that "the high forecast of gross revenue of $107 million during year 3 of the agreement is only 0.6 percent of the total forecasted newspaper advertising revenue of $17.2 billion in 2014."[13] *Id.*

The Postal Service's comparison of postage revenue that it receives from NSA pieces to forecasts of newspaper advertising sales is inapt, and provides no grounds for concluding that the NSA would not cause undue marketplace harm.

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[12] *Rules Applicable to Baseline And Functionally Equivalent Negotiated Service Agreements*, Docket No. RM2003-5, Order No. 1391 at 38-42 (Feb. 11, 2004) (Order Establishing Rules Applicable To Requests for Baseline and Functionally Equivalent Negotiated Service Agreements). The proposed NSA would properly be classified as market-dominant under Section 3642.

[13] In the quoted language, the Postal Service mischaracterizes the $107 million figure as a single year, rather than as a total postage over three years as indicated in Attachment 6. Its financial numbers correctly treat it as a three-year total.

A. The Postal Service's Confusing Of Two Distinct Markets Cannot Justify The NSA

The issue addressed by Commission rule 42(f) (and the subject of Professor Panzar's testimony) is the need to examine closely and accurately the impact on the downstream advertising marketplace. The Postal Service's comparison of its *postage* revenue to newspaper *advertising* revenues fails the most basic principle of market analysis – it compares the wrong things. Comparing its *postage* revenue to total newspaper revenue in the downstream *advertising* market is apples-to-oranges. That is like comparing FedEx's delivery revenues to the value of goods sold by mail order catalog companies.

The market disruption relevant to this NSA will occur in the downstream durable goods advertising market. Newspapers compete in that market with Valassis, not with the Postal Service.[14] Surely the Postal Service does not believe that Valassis's high-end incremental revenue from the sale of advertising into this arrangement would equal $107 million, as it recognizes that Valassis will determine its own prices to offer advertisers. *Response of the United States Postal Service To Chairman's Information Request No. 3*, Question 4(b).

The Postal Service's comparison of postage revenues with total newspaper advertising revenues is irrelevant to the marketplace harm analysis and the Postal Service offers no other basis for showing that there is no unreasonable market harm. Thus, the showing required by Section

[14] The only advertising market in which newspapers compete with the Postal Service is in the local market where the Postal Service offers Every Door Direct Mail. The NSA protects the Postal Service by not allowing Valassis to take business from EDDM, so that advertising is not relevant here.

3622(c)(10)(B) of the PAEA and Commission Rule 3010.42(f) has not been made, and for that reason alone the NSA cannot be approved.

B. The NSA Would Cause Unreasonable Marketplace Disruption

A proper market assessment would have had to conclude that there is an undue risk of disruption in the downstream advertising market. Although the Postal Service tries to assure that the NSA "will have minimal financial impact of the marketplace" (*USPS Notice*, Attachment E at 6), there would be quantifiable harm to newspapers in the form of lost advertising revenue of up to $1 billion both immediately and over a longer period.

The NSA allows Valassis to offer greatly reduced prices to advertisers on an essentially risk-free basis, because if no takers come it can walk away cost-free for the first 90 days the NSA is in effect. In addition, the NSA calls on Valassis to include 3 to 10 inserts per piece, so the number of potentially affected advertisers is significant.

But the harmful effects would continue well beyond the first 90 days. Negotiations affect advertising rates, advertising planning, and numerous other financial considerations that go into publishing newspapers. Using the discounts and flat rates, Valassis can target certain advertisers with free or nearly free offers in order to build a package, knowing that the rebates will recover its costs.

Even if it doesn't win any business, Valassis could wreak substantial havoc on advertising competition in local markets. Although it could engage in a price war that is risk-free to it, newspapers would have to live with the aftermath.

For this reason, allowing the NSA to take effect, even if Valassis ultimately were to walk away, would itself allow marketplace disruption.

The Postal Service argues that two factors will minimize the financial impact on the market. One is that the new saturation shared mail programs under the agreement "are considered an alternative or supplement for existing distribution" and thus "is not expected to cause undo harm on existing channels." Attachment E at 6. This is disingenuous. Durable goods advertising is in the market today, and the NSA is designed to replace or substitute for existing distribution channels, as evidenced by the Postal Service's comparison to newspaper advertising forecasts.

The other factor is the rebate mechanism, which requires Valassis to pay full postage at the time of mailing with the cumulative rebates being paid at the end of the year. *Id*. The Postal Service says that this means Valassis will bear the upfront postal cost and risk, pending a subsequent rebate. *Id*. What the Postal Service ignores is that the rebate is guaranteed (there is no minimum volume threshold beyond the modest initial 1,000,000 pieces) and that Valassis will be able to use the knowledge of the impending year end rebate in effect to finance and subsidize disruptive rates to advertisers in the current year. There is no penalty if Valassis fails to mail a minimum number of pieces, and it can terminate the NSA at will. So the structure of the rebate mechanism provides the market little protection from harm.

Nor does Postal Service consider the indirect effects that result from declining newspaper advertising revenue, including (potentially) reduced circulation revenues as well. This, in turn, affects the ability of the newspaper to generate the editorial content that is the lifeblood of the community.

The Commission last year considered factors relevant to market disruption when it approved the market test of what has become Every Door Direct Mail. *See Market Test of Experimental Product—Marketing Mail Made Easy*, Docket No. MT2011-3, Order No. 687 (Mar 1, 2011). In that decision, the Commission considered whether other mailers were excluded, the duration and presence of a cap on revenues, and its own power to terminate the test. *Id*. at 10.

The proposed NSA fails this test. First, by definition, the NSA excludes other mailers. The eligibility criteria are drafted to foreclose any other mailer from being even close to eligible. Other mailers would have to attempt to negotiate a new NSA, a long and costly process with no guarantee of success.

Second, unlike in the case of a market test, the NSA includes no cap on revenues for the Postal Service, and certainly none on Valassis.

Third, in *Marketing Mail Made Easy*, the Commission cited its power under Section 3641(f) to order cancellation of a market test. It does not have the equivalent power here. After an NSA takes effect, it can terminate it only in a complaint proceeding brought pursuant to Section 3662 or, potentially, in an Annual Compliance Determination pursuant to Section 3653. In either case, the Commission's could exercise its authority to terminate only long after the damage is done. In particular, the Commission would not issue an Annual Compliance Determination that includes a full year of the NSA until March 2014.[15]

[15] The Postal Service's fiscal year ends on September 30. With a mid-June effective date and the 90 day lead, the NSA will barely be underway in FY12. FY13 will be the first full year of

This NSA is unlike other cases in which the Commission has excused the failure of the Postal Service to provide data regarding adverse effects on other mailers.[16] In none of those cases were there, as there are here, downstream competitors – also mailers – in a position to provide a more accurate analysis of market disruption.

II. THE NSA WOULD RESULT IN A NET FINANCIAL LOSS TO THE POSTAL SERVICE IN VIOLATION OF SECTION 3622(c)(10(A)

Under Section 3622(c)(10)(A)(i) and Commission rule 39 C.F.R. §3010(b)(3), the Postal Service must show that an NSA will result in a net financial benefit to the Postal Service. It has not done so, and it has not even presented the proper information. That alone means that the NSA cannot be found legally compliant. Moreover, the NSA is far more likely to result in a net financial loss to the Postal Service, as it is likely to drive away as much as six times as much TMC postage revenue, and corresponding contribution, as it stands to gain from Valassis.

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the NSA, and the Annual Compliance Determination for that year will not be issued until late March 2014, nearly two years from now.

[16] *Capital One*, Docket No. 2002-2 at 79; *Rate and Service Changes to Implement Baseline Negotiated Service Agreement with Bookspan*, Docket No. MC2005-3 at 44 (May 10, 2006) (Opinion and Recommended Decision); *Rate and Service Changes to Implement Baseline Negotiated Service Agreement with Life Line Screening*, Docket No. MC2007-5 at 37 (May 29, 2008) (Opinion and Recommended Decision); *Market Dominant Product Prices First-Class and Standard Mail Discover Financial Services*, Docket No. MC2011-19 & Docket No. R2011-3, Order No. 694 at 21 (Mar. 15, 2011).

A. The Postal Service Has Considered Only "New" Volume From Valassis And Has Ignored The NSA's Effects On Newspapers' TMC Mail

As its basis for claiming a positive "net financial effect" of the NSA, the Postal Service touts solely the "new" volume it anticipates from Valassis pursuant to the NSA. *See USPS Notice* at 7 & Attachment E at 3 & Attachment F. Relying on data supplied by Valassis, the Postal Service provides a high-end estimate of the value of the contract at about $107 million in *gross* postage revenue over a three year period. The low end gross revenue estimate is $33,841,862.[17]

However, the legal criterion is *net* financial impact, and that depends not on *gross revenue* but on *net contribution*. The Postal Service estimates new contribution under the NSA ranging from a low of $4,745,972 to a high of $15,341,600, stressing the latter in its filing. *USPS Notice* at 7 and Attachment F. (The Postal Service has agreed to give Valassis about 63 percent of these unit contribution from the "new" pieces through the rebates.[18]) At the high end, that equates to a net unit contribution to the Postal Service of merely $0.0348 per new piece.

Although the Postal Service has considered only "new" mail by Valassis, the "net financial benefit" test is not so limited. In contrast, the "net financial

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17 *USPS Notice*, Attachment F, sheet SM Sat. Flats Rev Calc (sum of line 29).

18 At the high volume estimate, the Postal Service would return to Valassis through the rebates $26,647,259 – 63.4 percent -- of the $41,988,859 new "contribution," netting only $15,341,600. The Postal Service states that "If each of the pieces in this agreement generated [normal] unit contribution, the total contribution would be between $13 million and $42 million for the total three years of the agreement." *USPS Notice*, Attachment F, Tab Analysis Footnote.

benefit" test takes into account potential postage losses *from other mailers* as a consequence of the Postal Service favoring one mailer with the NSA:

> [T]he analysis necessarily must include an evaluation of lost contribution from non-parties to an NSA. This is because subsection (A)(i) refers to improving the net financial position of the Postal Service by increasing the overall institutional cost contribution. Ignoring the effect on contribution from other mailers would limit consideration to merely the gross effect from the NSA mailer and ignore the net impact on the Postal Service.

Regulations Establishing a System of Ratemaking, Docket No. RM2007-1, Order No. 43 at 60 (Oct. 29, 2007). That is why the Commission's rules require the Postal Service to provide "An analysis of the effects of the negotiated service agreement on the contribution to institutional costs from mailers not party to the agreement." 39 C.F.R. §3010.42(d)(3).

Here, the Postal Service has *completely* failed to consider postage losses from other mailers. This omission is inexcusable. One would expect that a group of longstanding mailers that represent more than 25 percent of the revenue in the product from which a proposed NSA arises would be mentioned in the part of the Postal Service's filing in which it is required to address whether an NSA would affect other mailers. Yet one searches the *USPS Notice* in vain for even a glimmer of recognition that this $500 million annually of newspaper TMC mail exists, or of the effect of the Valassis NSA on that mail. This omission is particularly striking because those mailers would pay a much higher contribution per piece.

This failure to comply with the Commission's rules alone is sufficient grounds for holding the NSA to be not in compliance with law.

B. The Postal Service Would Lose More Revenue And Contribution From Newspaper TMC Mail Leaving Than It Would Gain From Valassis

If the Postal Service *had* considered the possible losses from reduced postage from other mailers, it would have recognized the strong probability that the revenue and contributions losses from the newspaper TMC mail alone that it will lose would more than offset the relatively small profits the Postal Service anticipates from new Valassis mail.

The Postal Service seems to think that little current mail is at risk. *See Response to Chairman's Information Request No. 1*, Question 1 (asserting that NSA mail would consist of "new volumes, revenues, and costs that would not exist absent this agreement") & *USPS Notice*, Attachment E at 4. That is incorrect.

What the Postal Service has failed to consider is that newspapers that deliver, but do not mail, substantial durable goods advertising would likely take their TMC programs that contain other types of advertising out of the mail in response to the NSA. This would happen for the following reason. To the extent Valassis takes national durable goods advertising business away from newspapers, newspapers would lose revenue. Newspapers would have to reduce their costs to stay competitive -- and although many TMC programs would prefer to remain in the mail, postal rates are one of the few big line items that can be reduced without cutting journalism staff. As a result, newspapers have told NAA that if they suffer revenue losses to Valassis due to the NSA (or due to less revenue from lowering ad rates to retain business), they will reduce their postage expenditures for TMC programs across-the-board, including for mid-week TMC packages that do not include preprints for durable goods.

Newspapers would not have to reduce their postage expenditures by much for the NSA to be a financial loss to the Postal Service. According to the Annual Compliance Determination for FY2011, the average Saturation and High-Density flat contributed 8.78 cents to institutional costs. Postal Regulatory Commission, *Annual Compliance Determination Fiscal Year 2011* at Table VII-11 (March 28, 2012). This may understate the actual contribution from TMC mail, which typically weighs above the breakpoint and thus pay rates that include a larger unit contribution.[19] Yet it is far more than the net average unit contribution to the Postal Service of $0.0348 per new piece under the NSA.

Assuming 8.78 cents of contribution per piece, a *total* of only 174,733,485 TMC mailings would need to leave the postal system over the three years of the agreement in order to offset completely the high end revenue of $107 million and estimated new NSA contribution of $15,341,600. That is a reduction of roughly 58,000,000 newspaper TMC mail pieces per year. At the low end, merely 54,054,350 *total* pieces over *three* years, or merely 18,020,000 pieces per year,

[19] Above-breakpoint pieces likely make more than the average unit contribution. Attachment F, Tab Analysis Footnote ("In fact, heavier pieces (like those subject to the agreement) would contribute more per piece, if the additional revenue (over and above the "average piece") is greater than any added cost that might be caused by additional weight. The added cost due to weight would have to be much greater proportionally (versus the added revenue) to eliminate the contribution per piece"). But this would be true of both the "new" Valassis pieces under the program and TMC pieces that would leave the system. NAA lacks any reason to assume that the net effect on each type of piece is other than the same.

a trivial amount – of TMC flats would need to leave the mail for this NSA to produce a net loss of contribution to the Postal Service.[20]

Recent history shows that declines in TMC mailings of these magnitudes can reasonably be expected were the NSA to take effect. As a case in point, in early 2009, the Postal Service raised the High Density flats rates by 5 to 11 percent while holding Saturation rates essentially flat (and introducing an incentive discount). At that time, NAA stated that "newspaper TMC programs, facing much higher postal rates than their competitors, will have strong incentives to leave the postal system altogether and shift into private delivery."[21]

That prediction proved to be accurate. The Mather study commissioned by NAA and cited by the Postal Service concluded that postage paid by newspaper TMC programs declined about $80 million in 2009 due to those higher postal rates, in addition to some $40 million lost the year before also due to postage rates[22] – a two-year total loss of $120 million. The study concluded that more TMC volume would leave the mail in 2010 due to unfavorable postage rates, costing the Postal Service another $134 million in postage annually, and would persist in 2011 and 2012.

Actual results were consistent with these predictions. In FY2008, 13,584,059,000 pieces of Saturation and High Density Standard flats were

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20 18,020,000 pieces times $0.0878 per piece times 3 years = $4,746,484, compared to the $4,745,972 in gross contribution from Valassis using the "low" estimate.

21 *Comments on the Newspaper Association of America On Notice Of Market-Dominant Price Adjustment*, Docket No. R2009-2 at 3 (March 2, 2009).

22 Other factors, such as the economic recession, also contributed to further postage declines from TMC programs over that period.

mailed, totaling $2,171,756,000 in revenue.[23] In FY 2009, High Density and Saturation flats revenue fell to $1,977,872,000, consistent with NAA's estimate.[24] NAA's estimate of another $134 million loss of newspaper TMC postage in FY2010 is entirely consistent with the Postal Service's continued revenue decline to $1,853,432,000.[25] Standard Mail High Density and Saturation revenue in FY 2011 remained consistent with NAA's estimates.[26]

Although TMC postage appears stabilized around $500 million today, newspapers will not want to stay in the mail when the Postal Service is aggressively aiding their competitor's attempt to target their advertising. Based on what members are telling NAA, at least $200 million annually of this mail could leave the postal system if the Valassis NSA takes effect. Over the three years of the NSA, this would total some $600 million, dwarfing the $107 million in "new" revenue the Postal Service hopes to receive from Valassis. Why the Postal Service would want to hasten their departure is a mystery to NAA, as is the Postal Service's failure to address this issue.

III. THE NSA IS UNREASONABLY DISCRIMINATORY IN VIOLATION OF SECTION 403(c)

Section 403(c) of the Act prohibits the Postal Service from making:

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[23] Postal Regulatory Commission, *Annual Compliance Determination FY 2008*, Table III-2 (March 30, 2009).

[24] Postal Regulatory Commission, *Annual Compliance Determination FY 2009*, Table VII-11 (March 29, 2010).

[25] Postal Regulatory Commission, *Annual Compliance Determination FY 2010*, Table VII-15 (March 29, 2011).

[26] Postal Regulatory Commission, *Annual Compliance Determination FY 2011*, Table VII-11 (March 28, 2012).

> "any undue or unreasonable discrimination among users of the mails, nor shall it grant any undue or unreasonable preferences to any such user."

39 U.S.C. §403(c). The rates contained in the proposed NSA violate Section 403(c). The post-rebate prices to Valassis discriminate excessively against full-rate Standard mailers of the same durable and semi-durable goods advertising, including the flat-rates provisions, and as measured by both net postage rate or contribution per piece. Eligibility for the special rebated and flat-rated weight structure of the NSA is defined so as effectively to be available only to Valassis with no legitimate justification.

A. The NSA Discriminates Among Standard Mailers In Rates Both By The Size Of The Discount And Because Of The Flat Rates

The NSA would give Valassis alone among all Standard Mailers a unique rate schedule. Not only are the rebated rates much lower than Standard rates, but the rebate schedule also gives Valassis flat rates in the highly competitively-sensitive weights levels between 6.5 and 11 ounces. These create unreasonable differences between the net rates and contribution paid by Valassis and paid by all other, full-rate Standard Saturation and High Density mailers.

Rebates. The Table below presents, at three weight levels subject to the agreement, the year one unit costs relied upon by the Postal Service in the *USPS Notice*, and the rates and unit contribution that would be paid by Valassis, and at the High Density and full Saturation rates paid by TMC mail. Although these numbers are subject to change in years 2 and 3, the NSA is designed to produce similar results:

Wgt of piece	Unit Cost (unadjusted)	Valassis NSA Rate[27]	Valassis NSA Unit Contrib[28]	Non-NSA HD Rate	Non-NSA Unit Contrib (HD)	Non-NSA Sat Rate	Non-NSA Unit Contrib (Sat)
4 oz.	$0.065 (DDU)	$0.128	$0.063	$0.187	$0.122	$0.160	$0.095
7 oz.	$0.065 (DDU)	$0.172	$0.107	$0.254	$0.189	$0.227	$0.162
10 oz.	$0.065 (DDU)	$0.211	$0.146	$0.321	$0.256	$0.294	$0.229

(As the Postal Service concedes, the costs of the heavier pieces are likely higher than shown, which would decrease the actual unit contributions.)

This Table shows that the size of the rate rebates under the NSA are striking, ranging as high as about 35 percent[29] over normal Saturation rates. This results in extraordinary price advantages for Valassis, which would benefit it in the downstream market by allowing it to undercut market prices. For example, for an 8.9 ounce piece entered at the DDU, Valassis would pay a net *72 percent* less than a TMC program mailing the same weight piece at the DDU.

Consequently, the per piece revenue and contribution of NSA pieces are substantially smaller than those of full-rate pieces. For example, according to this Table a 7 ounce Valassis NSA piece would pay 10.7 cents in contribution. The same weight High Density piece would contribute 18.9 cents per piece – 8.2 cents or *76 percent more* than a Valassis NSA piece. A full-rate Saturation piece

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27 USPS Notice, Attachment F, Tab Discount Rebate, Column K.

28 NSA Rate minus Unit Cost.

29 This is the percentage rebate at 8.9 ounces.

would pay 16.2 cents in contribution, a 51 percent higher contribution. In other words, for every two High Density pieces that leave the system in response to the NSA, Valassis would have to mail more than three just for the Postal Service to break even.

The unit contributions of Valassis pieces in the Table are post-rebate, and are based on the Postal Service's unit cost estimates. But those unit contributions may be overstated. If one divides the $15,341,000 in claimed new contribution by Valassis's corresponding volume estimate of 440,000,000 pieces, the result is a net average unit contribution to the Postal Service of $0.0348 per new piece – well below the calculations above drawn from the Postal Service's filing. For perspective, that $0.0348 cents unit contribution for each new Valassis piece would be less than half the amount contributed by a saturation letter, barely 40 percent of that of a saturation flat, and 14 percent of that of a one-ounce First-Class Presort letter. If those unit contributions are overstated, the net NSA revenue would be even lower.

These wide differences between the rates and the unit contributions that would be paid by Valassis compared to full-rate TMC products are discriminatory. They even raise a question whether institutional costs are fairly apportioned. *See United States Postal Service v. Postal Regulatory Commission*, No. 11-1117 (D.C. Cir. April 17, 2012).

Flat Rates. Valassis also would receive extremely favorable rate treatment from the NSA 17.2 cent flat rate between 6.5 and 9 ounces and the flat 21.1 cent rate for pieces weighing 9 to 11 ounces. These flat rates, equating to rebates ranging from 21 to 36 percent off tariff rates, would be unavailable to any other Standard mailers, who would continue to pay the per piece + per pound rate structure that has been part of the Standard Mail rate design for decades.

What the flat rates do is enable Valassis to add preprint inserts to a package within those ranges without increasing its postage. This allows it great pricing flexibility in the downstream market when trying to attract preprints to its new pieces, including the financial ability to offer free or nearly free introductory prices. A competing mailer with a similarly weight piece would pay a higher rates as it adds pieces. This rate discrimination gives Valassis a considerable advantage over other mailers when negotiating with advertisers.

B. The Discrimination In Rates And Contribution Between NSA Rebated Rates And Full Rates Is Not Justified

In its recent decision in the *Gamefly* complaint proceeding, the Commission reviewed the elements of an undue discrimination claim. These are:

- That the complaining party has been offered less favorable rates or terms and conditions than one or more other mailers
- That it is similarly situated to the other mailer or mailers who have been offered more favorable rates or terms and conditions of service;
- That there is no rational or legitimate basis for the Postal Service to deny it the more favorable rates or terms offered to others.

Complaint of GameFly, Inc., Docket No. C2009-1, Order No. 718 at 28 (April 20, 2011).[30]

Here, the first element is easily satisfied. The steeply discounted rates resulting from the rebates offered via the NSA and the lower unit contributions

[30] In *GameFly*, the Commission noted that its prior rulings developing its approach to Section 403(c) were in NSA cases. Order No. 718 at 44-45.

would not be available to any mailed newspaper TMC product because the terms of eligibility uniquely describe Valassis. The Postal Service has declined to address what could be a similarly situated mailer. *Response to Chairman's Information Request No. 3*, Question 1.

The second element is satisfied as well. Newspaper TMC programs mail substantial volumes, and often are the largest Standard mailer in their market. They have years of experience in conducting and managing shared mail programs, and can enter mail at the DDUs. Some newspaper companies publish newspapers in many states across the nation. They are perfectly capable of mailing the advertising of national durable and semi-durable goods retailers – and in fact many do so today.

The third element is also satisfied. The Postal Service has identified no legitimate basis for these rate and contribution discriminations. What the Postal Service has said is that the NSA is not available to any other mailer because the NSA's "defining characteristics" are Valassis's "size" and "its nationwide distribution network." *USPS Notice,* at 7.

The restriction to a national mailer is arbitrary. The mail subject to the NSA must be entered at local DDUs or SCFs, and Valassis's national operations confer it with no unique ability to do so. In addition, newspapers are capable of distributing print advertising for national retailers of durable goods, as a casual perusal of newspaper weekend advertising inserts makes clear. Furthermore, several companies, such as Newspaper Services of America, Vertis, and News

America, currently provide the marketplace with the means to coordinate the national advertising objectives of large durable goods retailers.

It is noteworthy that the Postal Service makes no attempt to justify this discrimination on costs. Without "cost savings to the Postal Service, the benefits that the Postal Service is to receive under a proposed NSA should be carefully examined due to additional issues – not present in NSAs that have a cost savings element – that potentially may arise in such agreements." *Rate and Service Changes to Implement Baseline Negotiated Service Agreement with Bookspan*, Docket No. MC2005-3, Opinion and Recommended Decision at 35 (May 10, 2006). In *Bookspan*, the Commission concluded that non-cost-justified NSAs were permissible "so long as the essential features of the NSA are available to other similarly situated mailers and there is a reasonable justification for the agreement." *Id*. at 43.

Neither condition exists here. The NSA precludes any other mailer from being similarly situated, and there is no reasonable justification. In *Bookspan*, the "reasonable justifications" were a multiplier effect and contractual risk mitigation. Neither exists here.

In fact, the few commitments that the Postal Service has obtained from Valassis -- which let Valassis try to sell advertising into the program risk-free for at least 90 days – hardly justify the drastically rebated NSA rates.

If private delivery costs as little as the Postal Service says, Valassis could easily convert. If the Postal Service wants to compete with private express firms, it could lower rates and/or create a generally available flat-rate structure. It does not, because it wants to maintain the ability to engage in rate discrimination to charge higher rates to all other customers, singling out just Valassis for special treatment. That is precisely what Section 403(c) prohibits.

CONCLUSION

Instead of entering an arrangement that lacks a legally adequate basis, will disrupt the downstream market, drive out many longstanding customers, and cause it to lose money, the Postal Service would be better served by taking measures to reduce its costs and welcome all mailers with reasonable, nondiscriminatory rates and terms.

For the foregoing reasons, the Postal Service's proposed NSA with Valassis is not in compliance with statutory criteria, and should be rejected.

Respectfully submitted,

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